

4 May 2007

Mr E J Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
BRISBANE Qld 4001

Dear Mr Hall,

QR ACCESS UNDERTAKING AMENDMENT – FORM OF REGULATION

The QCA's Draft Decision on the Form Of Regulation in the current QR Access Undertaking (UT2) indicates the QCA's support for the proposed change from a price cap to a revenue cap, provided that QR makes certain modifications to improve the workability and fairness of the scheme.

Pacific National's previous submission on this matter supports the adoption of a revenue cap for the central Queensland coal rail systems, albeit with some significant differences in form to that proposed by QR. Given the limited scope within which the QCA is required to consider the QR proposal, particularly that this change is occurring 'mid-term' through UT2, it is understood that a number of the issues that Pacific National raised were seen as matters that could be not addressed as part of this amendment. Within that context, Pacific National supports the decisions of the QCA in its Draft Decision with respect to the scheme to apply for the remainder of the term of UT2 subject to the specific comments at the end of this submission.

However, Pacific National believes:

- that this should not be seen as necessarily endorsing this scheme into future access undertakings; and
- that it is necessary to mitigate the impacts of regulatory change that results in a diversity of access arrangements applying to different parties purely on the basis of when the contract was entered into.

Pacific National believes that the existing proposal (including the amendments required by the QCA), while addressing short term needs driven by the form of UT2, introduces or reinforces unnecessary complexities and exacerbates the divergence of access arrangements between the previous undertaking (UT1) and UT2.

While UT2 may have only slightly more than 2 years until it is due to be replaced, it is quite possible that access arrangements for commencement of services up to 2011 (given that these

Pacific National Pty Ltd
ABN 39 098 060 550

Pacific National (ACT) Ltd
ABN 48 052 134 362

Pacific National (NSW) Pty Ltd
ABN 83 099 150 688

can be negotiated up to 2 years in advance of commencement of services) would be negotiated under UT2, or at least might be negotiations commenced under UT2 and therefore will be affected by this amendment. Further, if any long term access agreements are negotiated under this arrangement, the impacts of disparities between the UT1, UT2 and any future arrangements have the potential to remain into the long term.

With each iteration of the regulatory arrangements, if no mitigations are put in place, it is likely that the special arrangements required to quarantine pre-existing, long term commitments will become more complex and tortuous. This problem is most clearly associated with managing the Queensland coal networks, where the arrangements must necessarily deal with system outcomes (eg ceiling revenue limits across a specific part of the rail network) while at the same time attempting to segregate responsibility between different parties as though they were acting in isolation (eg individual load-point take or pay arrangements).¹ This seems to give rise to a series of potentially conflicting outcomes. As seen in UT1, these can be managed, though at the cost of complexity and compromise,² but it is clear that there is a tension between the concepts of dealing with a system as a whole and dealing with the system's individual components, especially where there is a substantial degree of common usage, as occurs on the coal rail networks.

In Pacific National's opinion, such tensions become increasingly strained when an additional dimension is added through the means of adopting different regulatory arrangements that are required to co-exist. The current proposed changes have highlighted the impact of differences between UT1 and UT2 that might not have previously been apparent, eg the take or pay arrangements.

UT2 is significantly more complex than other access arrangements currently in use on Australian rail networks, and these amendments will increase that complexity. It is quite probable that at some point during the life of the UT2 arrangements, there will be different tranches of coal tonnages being hauled under different regulatory arrangements from the same load point by the same operator – who is to say which tonne of coal was hauled under which arrangement on the day and therefore which take or pay obligation is invoked?

Pacific National is of the view that these complexities detract from competition between train operators rather than facilitate it and that, given the current approach to regulation, ie that contracts arranged under one regulation are immune to subsequent regulatory change, will only lead to increasing problems over time. This is not to say that Pacific National is advocating that existing contracts should be abrogated. However, there is again a tension between concepts where contracts can be entered into that are quarantined from regulatory change and yet regulation can be changed in an environment where the whole of the system has to be accounted for.

To Pacific National's knowledge, this problem has not been subject to any significant public consideration by the QCA with respect to the regulation of the QR rail network. It is increasingly clear that such consideration is becoming necessary. As a spur to consideration of the issue, the next QR Access Undertaking (UT3) will soon be under active construction by QR in order to have it approved in time to take over from UT2. With this in mind, Pacific National suggests that the QCA has a role in bringing the stakeholders together to consider the impacts

¹ By way of contrast, the problem of inter-temporal incompatibility does not appear to arise to any significant extent where it is not necessary to treat the network on a system basis (eg where revenues are below the ceiling and therefore pricing is not interdependent between access contracts).

² For example, under UT1, the take or pay provisions looked firstly to system-wide results and then applied to individual hauls if the system performance triggered a parameter. Thus this was neither based on wholly system performance nor individual performance but was a compromise between the two concepts.

of regulatory change over time and the options available to mitigate these impacts before the preparation of UT3 is so advanced as to preclude fundamental change.

With regard to specific decisions contained in the Draft Decision, Pacific National makes the following brief comments:

Portability Of Contract Arrangements

Given the general concerns raised in the preceding discussion regarding the difficulties of different access arrangements, Pacific National recognises that the QCA is attempting to mitigate these problems through requiring the transfer of take or pay and relinquishment provisions where the related access rights transfer from a UT1 contract to a UT2 contract. To this extent, Pacific National supports that proposal. However, as discussed above, while this addresses the imbalance between the access holders, it does not address the problem of having different arrangements potentially applying to essentially the same hauls and Pacific National is not convinced that this will become administratively cumbersome both for QR Network Access and the access contract holder.

Volume Incentive

The QCA proposes to allow QR to retain revenue up to 2% above the revenue cap where this is a result of QR's 'initiative'. In its previous submission, Pacific National suggested that such a mechanism was unnecessary and merely served to distort the revenue cap model. While it is accepted that the QCA is persuaded by the argument that the proposed model provides an incentive to QR to perform, it is unclear why, if this is the case, the logic would not extend to providing a negative incentive in the form of up to a 2% under-recovery where circumstances warranted. The Draft Decision did not seem to canvas any compelling reason for adopting what appears to be an unbalanced approach. Pacific National sees the reduction of the System Allowable Revenue for 'negligence or breach' as a basic part of the revenue cap concept and not part of any incentive arrangement. Given the terms and conditions in the standard access contract, the mere under-provision of capacity will not necessarily lead to negligence nor breach and the ability of the parties to judge, let alone prove, when negligence or breach must be limited under normal operating conditions, so this is unlikely to give rise to a counter-balance to the positive incentive to perform.

Further, it is clear that the decision is at the discretion of the QCA and there are no substantive criteria that would assist either QR or other interested parties in understanding the basis for such a payment. Pacific National's view is that if such a payment is to be allowed it should be based on a very simple and unambiguous measure such as being directly related to volume throughput (noting that this gives the potential incentive to under forecast available capacity to assist with over-achievement and avoidance of the downside – not dissimilar to the problems associated with the price cap) and it should be a symmetrical arrangement.

Overs And Unders Mechanism

The refunding or recoupment of a difference to the system allowable revenue is through adjustment to the components of the access charge. This would appear, in concept, to result in an averaging of the effect of the UT1 and UT2 take or pay arrangements and also the impact of take or pay across all access holders within each of those arrangements – in effect a socialisation of the outcome. This effect not discussed in either the Draft Decision or the QR proposal and it is unclear to Pacific National whether this was an intended consequence. Pacific National's previous submission argued that a preferred approach is one that explicitly recognises the need to socialise the cost of each system among system users (as occurs in the NSW Hunter Valley) and therefore is not opposed to this outcome per se. However it would seem to

be contrary to the intention of the other measures introduced to quarantine the effects of over or under-performance and to segregate the impacts between different contracts. It would be helpful for the QCA, in its Final Decision to demonstrate through a comprehensive example how the intended mechanism would work so that the separation of the effects of the different take or pay arrangements both between regulatory periods and between load-points within the same regulatory period is maintained while still retaining the admirable advantage of a single set of reference tariffs for each system.

A handwritten signature in black ink, appearing to read "Paul Bugler". The signature is fluid and cursive, with the first name "Paul" and the last name "Bugler" clearly distinguishable.

Paul Bugler
Access & Regulation